

U.S. COURTS

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CAMERON S. BURKE,
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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF IDAHO

In re:

DAVID SILVA and SHARON
SELMASSKA,

Debtors.

FIRST FIDELITY BANK,

Appellant,

vs.

JOHN H. KROMMENHOEK,

Appellee.

Bk. Case No. 93-02385 ✓

Adv. Case No. 95-6117

ORDER

Case No. CV97-518-S-EJL

First Union National Bank, successor in interest to Defendant First Fidelity N.A., New Jersey, appeals the bankruptcy court's order denying First Union's motion to set aside a default judgment entered in favor of the Chapter 7 Trustee and against First Fidelity. First

ORDER - Page 1
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C.C. JUDGE *RAMAS*

110

Union contends that the default judgment is void because the bankruptcy court lacked subject matter jurisdiction over the adversary action. See Fed. R. Civ. P. 60(b)(4); Fed. R. Bankr. P. 9024. Having been fully briefed by the parties, this matter is now ripe for the Court's review. The Court finds that the facts and legal arguments are adequately presented in the briefs and record. Accordingly, in the interest of avoiding further delay, and because the Court conclusively finds that the decisional process would not be significantly aided by oral argument, this appeal shall be decided on the record before this Court without oral argument. Fed. R. Bankr. P. 8012.

"The bankruptcy court's denial of [a] Rule 60(b)(4) motion to set aside the default judgment as void is a question of law reviewed de novo." Virtual Vision, Inc. v. Praegitzer Indus., Inc., 124 F.3d 1140, 1143 (9th Cir. 1997).

The parties are familiar with the factual and procedural background of this case and the Court will not repeat it in detail here. The Trustee initiated an adversary proceeding seeking a judgment for the turnover of all funds deposited by the Debtor, David Silva, with First Fidelity in an account registered under the name of Milano-Silva, Inc. The Trustee's turnover action was predicated on 11 U.S.C. § 542, which identifies the duties imposed on those in possession of property of a bankruptcy estate. See, e.g., Boyer v. Carlton (In re U.S.A. Diversified Products, Inc.), 100 F.3d 53, 56 (7th Cir. 1996) (explaining that "purpose of the section is to empower the trustee in bankruptcy to get hold of the property of the debtor, some of which will be in the possession, custody, or control of third parties."). There is no question that a turnover is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). See, e.g., John Hancock Mutual Life Ins. Co. v. Watson Kincaid (In re Kincaid), 917 F.2d 1162, 1165 (9th Cir. 1990).

First Union contends, however, that the Trustee was not seeking to obtain *property* of the debtor as required by 28 U.S.C. § 157(b)(2)(E), "but [was] instead seeking to obtain *property owed to the debtor, but belonging to a third party.*" (Appellant's Opening Br. at 25 (quoting In re Kincaid, 917 F.2d at 1165)). The Court disagrees. The complaint states that the Trustee seeks to "recover the possession of all funds deposited with the Defendant [First

Fidelity] under the name of Milano-Silva, Inc., by the Debtor, David Silva." The complaint then goes on to state that the Trustee "is entitled to recover the funds which were deposited with the Defendant due to the fact that said funds are property of the bankruptcy estate under the provisions of Section 541 of the Bankruptcy Code." Section 541 defines property of the estate as "all legal and equitable interests of the debtor."

Taken together, the allegations contained in the Trustee's complaint clearly set forth a right to the money deposited with First Fidelity based on the Debtor's ownership interest in those funds. The fact that the bank account was registered in the name of Milano-Silva, Inc. does not, as First Union contends, conclusively demonstrate that funds deposited to that account belonged to the corporation. See, e.g., Erhardt v. Leonard, 657 P.2d 494, 497 (Idaho Ct. App. 1983) (explaining that "[a]ccount contracts . . . define the power of withdrawal held by each party to the account, as a means of protecting the financial institution, [b]ut the actual ownership of the funds in the account is not affected by the account contract").¹ To the contrary, ownership of the account funds could be determined only after consideration of numerous factors. Cf. Boyer v. Davis (In re U.S.A. Diversified Products, Inc.), 193 B.R. 868, 873-74 (Bankr. N.D. Ind. 1995) (finding in turnover proceeding that owner of account funds was corporation rather than corporation's principal after considering the following factors: account was registered in corporate name, corporate address was used on account, the federal tax identification number belonged to the corporation, and the funds in question had been withdrawn pursuant to a corporate resolution), aff'd, 196 B.R. 801 (N.D. Ind. 1996), aff'd, 100 F.3d 53 (7th Cir. 1996). Of course to prevail in the adversary proceeding the Trustee would have been required to prove that the Debtor owned the money in the account. See Matter of Alofs Mfg. Co., 209 B.R. 83, 91-92 (Bankr. W.D. Mich. 1997) (explaining that to prevail in turnover litigation a trustee must prove by a preponderance of

¹ State property law determines the property which is to be included in the bankruptcy estate. Butner v. United States, 440 U.S. 48, 55 (1979). To the extent that state law enters into the Court's analysis, it is unnecessary to decide whether the laws of Idaho or New Jersey control this case; the principles of state law relied upon are common to both jurisdictions.

the evidence that the property is property of the estate, that the property is in the possession, custody or control of an entity, and that the property has more than inconsequential value or benefit to the estate). However, because First Fidelity failed to appear, the Trustee was never put to its burden. Nevertheless, the Trustee did all that was required to confer jurisdiction on the bankruptcy court under 28 U.S.C. § 157(b)(2)(E): the Trustee initiated a turnover action in which it was specifically alleged that an entity, First Fidelity, held in its "possession, custody, or control" property of the Debtor.² See In re Kincaid, 917 F.2d at 1165 (holding that bankruptcy court had jurisdiction over turnover action even though trustee ultimately failed to prove property in question was in fact property of the estate); In re U.S.A. Diversified Products, Inc., 100 F.3d at 55-56 (retaining jurisdiction over turnover action even though it was disputed whether property in question was in fact property of the estate).

Ignoring the Trustee's allegations discussed above, First Union focuses instead on a single paragraph of the complaint which states: "That the Plaintiff is informed and believes that the Debtor, David Silva, owns a majority of the outstanding stock of Milano-Silva, Inc." (Appellant's Opening Br. at 20). Relying on this paragraph, First Union reasons that the Trustee sought the funds in the corporate account based on the Debtor's status as majority stockholder. Viewing the complaint in this manner, First Union argues that the Trustee was not attempting to obtain property of the estate but instead was seeking to obtain money belonging to the corporation that might have been owed to the Debtor. Cf. In re Kincaid, 917 F.2d at 1165.

Although the Court disagrees with First Union's characterization of the complaint, the turnover would still meet all jurisdictional requirements even if the Trustee had grounded its

² The Court declines First Union's invitation to create a standard which would limit the bankruptcy court's subject matter jurisdiction to turnover proceedings where the "property sought is indisputably property of the estate." This proposed standard is directly at odds with Ninth Circuit case law. See, e.g., In re Kincaid, 917 F.2d at 1165 (holding that bankruptcy court had jurisdiction over turnover action even though trustee ultimately failed to prove property in question was in fact property of the estate).

right to the account funds on the Debtor's ownership of "a majority of the outstanding stock of Milano-Silva, Inc." A bankruptcy court may reach funds held in the corporate name when in fact the property belongs to the debtor/stockholder. See, e.g. Estate of Daily v. Lilipuna Associates (In re Daily), 107 B.R. 996, 1006 (D. Haw. 1989) ("It is clear that a Bankruptcy Court can pierce the corporate veil and attribute assets or liabilities to the shareholders of a corporation, and that equity will allow it to do so in order to achieve a just result."), rev'd on other grounds, 940 F.2d 1306 (9th Cir. 1991); Minich v. Gem State Developers, Inc., 591 P.2d 1078, 1084 (Idaho 1979) (collecting cases from numerous jurisdictions supporting principle that circumstances may "warrant casting aside of the separate corporate existence . . . to reach corporate assets"). The power of the bankruptcy court to reach corporate assets in this manner is grounded on the understanding that in some instances the debtor/stockholder is the equitable owner of the property. Accordingly, a turnover proceeding may properly be used by the Trustee to obtain corporate assets in which the debtor/shareholder possesses an equitable interest. 11 U.S.C. §§ 541(a)(1), 542(a); see In re MacDonald, 114 B.R. 326, 332-33 (D. Mass.1990) (piercing the corporate veil in bankruptcy case to establish debtor as the equitable owner of corporate stock that ostensibly was owned by debtor's father, and therefore finding stock subject to turnover order). And therefore subject matter jurisdiction exists to determine "the nature and extent of property of the estate." In re Kincaid, 917 F.2d at 1165 (citing 28 U.S.C. § 157(b)(2)(A)).

Finally, First Union implies that the bankruptcy court erroneously treated the turnover as a money judgment owed to the Debtor by First Fidelity. (Appellant's Opening Br. at 4, 18). In fact, the bankruptcy court acted in accordance with statutory requirements. Section 542(a) requires an entity in possession, custody, or control of a debtor's property to deliver to the trustee the "property or the value of such property." Thus, the statute anticipates the possibility that an entity, such as First Fidelity, would be liable for the value of account funds even though "by the time the trustee got around to demanding the money . . . [First Fidelity] no longer had it." In re U.S.A. Diversified Products, Inc., 100 F.3d at 56. "Otherwise, upon receiving a demand from the trustee, the possessor of property of the debtor could thwart the

demand simply by transferring the property to someone else.” *Id.* To avoid this possibility, once a possessor is on notice that a bankruptcy proceeding has begun, and that it may involve property in the possessor’s custody, § 542(c) obligates the possessor “to conduct a reasonable inquiry to determine whose property” it holds. *Id.* at 57. In this case, the Trustee informed First Fidelity on June 23, 1994, that the account registered under the name Milano-Silva, Inc. contained funds of the Debtor. Despite this notice, on July 22, 1994, First Fidelity allowed the funds to be withdrawn from the account. Having been notified of the bankruptcy proceeding and the debtor’s ownership interest in the funds, the bankruptcy court properly concluded that First Fidelity was liable for the value of the property. *See id.* at 56-57.

Accordingly, the bankruptcy court had subject matter jurisdiction over this matter at all times, and the order denying First Union’s motion to set aside the default judgment is hereby **AFFIRMED.** *th*

Dated this 16 day of September, 1998.


EDWARD J. LODGE
UNITED STATES DISTRICT JUDGE

United States District Court
for the
District of Idaho
September 16, 1998

* * CLERK'S CERTIFICATE OF MAILING * *

Re: 1:97-cv-00518

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Date: September 17, 1998

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